

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Policy and Rules Concerning the	)	CC Docket No. 96-61
Interstate, Interexchange Marketplace	)	
	)	CC Docket No. 98-183
Implementation of Section 254(g) of the	)	
Communications Act of 1934, as amended	)	
	)	
1998 Biennial Regulatory Review --	)	
Review of Customer Premises Equipment	)	
and Enhanced Services Unbundling Rules	)	
in the Interexchange, Exchange Access	)	
and Local Exchange Markets	)	
Implementation of the Local	)	
Competition Provisions in the	)	
Telecommunications Act of 1996	)	

COMMENTS OF NATIONWIDE BUSINESS TELEPHONE SYSTEMS, L.L.C.  
d/b/a TEAM CENTREX

Team Centrex, by and through its attorneys, files these comments in response to Section III.A. of the Further Notice of Proposed Rulemaking (the "FNPRM") released by the Commission on October 9, 1998.

I. INTRODUCTION

The Commission seeks comment in Section III.A. of the FNPRM as to whether its prohibition against bundling of customer premises equipment ("CPE") with interstate, domestic, interexchange services "is no longer necessary in the public interest due to meaningful economic competition."<sup>1</sup>

Team Centrex wishes to comment on the FNPRM because of the potential impact of this

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<sup>1</sup> FNPRM at para. 13.

**Rulemaking on the local exchange market. Bundling is potentially restrictive in the interexchange market. It is absolutely restrictive in the local exchange market.**

**Team Centrex agrees with IDCMA that an interexchange carrier may have the ability to force its customers to purchase CPE even if that interexchange carrier lacks market power. Team Centrex is particularly concerned with the possibility that an interexchange carrier could provide transmission service to customers who buy CPE from that carrier or could make transmission service available only to those customers who purchase its CPE. Both of these types of activities would clearly violate Sections 201 and 202 of the 1996 Telecommunications Act (the "Act"). Finally, Team Centrex agrees with IDCMA, CERC and ITAA that permitting nondominant interexchange carriers to bundle CPE and interstate, domestic, interexchange services would allow the carriers to subsidize the costs of providing equipment with the charges for service. There can be no doubt this will occur -- the practice is in place today in the local exchange market.**

**Team Centrex is concerned that exempting nondominant interexchange carriers from the "nonbundling" rule will pave the way for the bundling prohibition to be lifted in the local exchange market. Such prohibition is necessary to avoid unreasonably discriminatory practices. Dominant LECs who provide regulated telecommunications services are allowed to recover a substantial portion of their fixed and variable expenses through regulated activity. This means that not all costs associated with CPE are reflected on the CPE operations books and thus these carriers' CPE costs are subsidized. Allowing local exchange service and CPE to be bundled at a single price will provide every local exchange provider the ability to destroy CPE competition by**

pricing CPE below the cost of its CPE competitors.<sup>2</sup>

Further, competitors driven from CPE markets and consumers stripped of CPE choice will have no recourse at law. In addition to not being subject to regulation by the Commission, (assuming that the Commission did not impose Title II regulation on CPE), the local exchange provider will be able to evade predatory pricing claims brought in antitrust courts because the CPE costs will be commingled with service costs. Thus, the local exchange provider's CPE offering will neither be scrutinized by regulatory bodies nor by antitrust laws.

Consider the present practice of SBC's subsidiary Pacific Bell. Pacific Bell presently subsidizes its Centrex CPE offering with Centrex revenues.<sup>3</sup> This pricing scheme allows Pacific Bell to keep its overall 40% bottom line profit rate in Centrex intact and to selectively offer discounts to those new Centrex customers who accept its Centrex CPE offering. Pacific Bell's Executive Vice President Martin Kaplan admitted that Pacific Bell could have reduced the price of Centrex if it wanted to, but chose to simply absorb some of the profit out of Centrex to provide the additional CPE services, because Pacific Bell thought it would stimulate more Centrex revenue and, over time, make more money.<sup>4</sup> Over four years, Pacific Bell's \$483 million in profits from Centrex offset its \$24 million losses from offering Centrex CPE.<sup>5</sup>

Pacific Bell's practice of cross-subsidizing Centrex CPE with Centrex revenue has in fact

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<sup>2</sup> This, in fact, has already happened in at least one geographical area, as will be discussed below.

<sup>3</sup> Team Centrex will file a formal complaint with the Commission requesting a declaration that these practices are unlawful under 47 U.S.C. § 202(a).

<sup>4</sup> Testimony of Pacific Bell's Executive Vice President Martin Kaplan at pgs. 1505-1506, attached hereto as Exhibit 1.

<sup>5</sup> Testimony of Pacific Bell's Director of Product Economics John Faris at pgs. 2739-2741 and trial exhibit 389.01-17, attached hereto as Exhibit 2.

driven virtually all Centrex CPE providers from the market in Pacific Bell's franchise area and continues today to bar them from reentry. The testimony of the President of Centrex Technologies was undisputed:

After that period of time when Joint Marketing occurred, many of [the independent CPE vendors] either went out of business or went out of that business. In my case, I went out of that business.<sup>6</sup>

The foregoing demonstrates that allowing CPE to be bundled with local exchange services will serve only to eliminate consumer choice and competition for CPE whenever the provider unilaterally decides, as did Pacific Bell, to subsidize the cost of CPE with local exchange revenue. Team Centrex opposes the removal of the prohibition against bundling CPE and transmission services in the interstate, interexchange market because of the distinct danger that such a rule would encourage practices prohibited by Section 202 of the Act and would eventually provide the basis for bundling to be permitted in the local exchange market, thus barring all independent CPE vendors from the Centrex CPE market and leaving the public little choice but to purchase CPE and transmission services from the same local exchange carrier.

Respectfully submitted,

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<sup>6</sup> Testimony of Scott Morgan at page 853, attached hereto as Exhibit 5.

1 MR. KIMBALL: Well, your Honor, with agreement of  
2 counsel, we're taking Mr. Kaplan this morning because of  
3 availability issues.

4 THE COURT: Yes.

5 MR. KIMBALL: Okay.

6 THE COURT: Proceed. He'll be the next witness?

7 MR. KIMBALL: Yes, your Honor.

8 THE COURT: All right. He may be sworn.

9 Where is Mr. Kaplan? Ah, yes.

10

11 MARTIN ALAN KAPLAN, + (776)  
12 a defendant herein, called as a witness by the plaintiffs  
13 under the provisions of Section 776 of the Evidence Code,  
14 was sworn and testified as follows:

15 THE CLERK: Please be seated.

16 Please state and spell your name for the  
17 record.

18 THE WITNESS: Martin Alan Kaplan, M-a-r-t-i-n,  
19 A-l-a-n, K-a-p-l-a-n.

20 THE COURT: Proceed.

21 MR. JONES: Good morning, ladies and gentlemen.

22

23 CROSS-EXAMINATION +

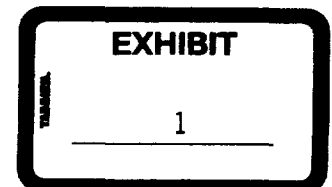
24 BY MR. JONES:

25 Q. Good morning, Mr. Kaplan.

26 A. Good morning.

27 Q. Sir, how are you currently employed?

28 A. I'm employed by Pacific Bell.



1     Introlink was a company of which CEA was a division. All  
2     of our relationship was with CEA, and I don't want to  
3     confuse it. We had no relationship with Introlink in  
4     terms of doing business with Introlink as a company.

5             Q.       Well, that's not actually true, is it,  
6     because Introlink itself was restricted from making any  
7     sales -- the other division of Introlink was restricted  
8     in the Contract from making any sales to a customer if  
9     they were a referral customer. Were you aware of that?

10            A.       The --

11            Q.       We're already reviewed the Contract with  
12     Mr. Sherman.

13            A.       Well, then, he'd probably answer the  
14     question.

15            Q.       Okay. But to your knowledge -- you don't  
16     have any knowledge to the contrary, do you?

17            A.       No. I don't have any knowledge either way  
18     on that part of it.

19            Q.       Okay. But the question that I'm trying to  
20     get to -- and I'm sorry it's taking me so long to do it,  
21     you know, it's getting late in the day -- Pacific Bell  
22     didn't charge the customer for any additional -- any  
23     additional amount other than that which was charged by  
24     Introlink despite the fact that Pacific Bell was  
25     providing these services; correct?

26            A.       We charged the customer for the services  
27     through Centrex. We chose, out of the profit on Centrex,  
28     to pay for the promotion that we called Joint Marketing.

1 So the customer paid for it. We could have reduced the  
2 price of Centrex if we wanted to do that. We chose to  
3 simply absorb some of the profit out of Centrex to  
4 provide this additional set of services because we  
5 thought it would stimulate more Centrex revenue and, over  
6 time, we would make more money.

7 Q. Okay. Let's follow along with that line of  
8 reasoning. Centrex was a tariffed product, was it not,  
9 and the same price for Centrex was charged to everybody  
10 who bought it -- right? -- except unless it was a 96A  
11 contract and there was a special approval for a special  
12 deal?

13 A. That's correct.

14 Q. Okay. And let's say, for example, I'm ABC  
15 Corporation and I want to buy a hundred -- 100 Centrex  
16 line business telephone system.

17 A. Okay.

18 Q. Do you know how much Centrex lines are per  
19 line per month?

20 A. Depending -- it ranges somewhere maybe  
21 between 16 and \$25 depending on --

22 Q. Let's just call it 20, okay?

23 A. That's fine.

24 Q. Okay. Now, ABC -- what was it? -- ABC  
25 Contract -- let's call it ABC Contractors -- buys a  
26 hundred Centrex line system and they pay 20 times 100 per  
27 month for their Centrex lines; correct?

28 A. Okay. That's --

1 next witness.

2 MR. KIMBALL: Yes. I'd like to call to the stand  
3 Mr. John Faris.

4  
5 JOHN FARIS, +  
6 called as a witness by the defendants, was sworn and  
7 testified as follows:

8 THE COURT: Please be seated. State and spell your  
9 full name.

10 THE WITNESS: John David Faris, F-a-r-i-s.

11 MR. JONES: Your Honor, at this time I would just  
12 respectfully point out that Mr. Faris is not on the Pacific  
13 Bell witness list. He was produced in response to your  
14 order to have the most knowledgeable person about the  
15 Contracts Program testify, and then he turned out not to be  
16 that knowledgeable person. So, your Honor, we would object  
17 to any testimony beyond that which was presented at that  
18 time.

19 THE COURT: If he were produced under the court  
20 orders, that's even better than being on the witness list,  
21 so the objection's overruled.

22  
23 DIRECT EXAMINATION +

24 BY MR. KIMBALL:

25 Q. Mr. Faris, what is your current -- are you  
26 employed by Pacific Bell?

27 A. Yes, I am.

28 Q. And what is your current position?

EXHIBIT

2



1       since those are unregulated products, it's -- I don't  
2       believe they do much of anything with those reports.

3               Q.       Okay. Now then, we've heard that Pacific  
4       Bell is required by the FCC to keep track of the  
5       unregulated costs of Joint Marketing. What other kinds of  
6       costs do the FCC and the public -- California Public  
7       Utilities Commission require Pacific Bell to keep?

8               A.       We have to file large numbers of monitoring  
9       reports with both agencies. They include a large variety  
10      of activities, things like research and development  
11      expenses, expenses at \*Bellcor, our capital costs, interest  
12      expenses. We have run some programs for minority women  
13      business enterprises, the expenses of those, the expenses  
14      of research and development. In addition, we have to track  
15      any expenses for lobbying expenses for contributions,  
16      expenses for subscriptions, expenses for memberships,  
17      expenses for depreciation, expenses for paying taxes. A  
18      large number of expense reports we file with both agencies  
19      on a wide variety of activities.

20              Q.       And you would have a tracking report of some  
21      kind for each of those kinds of expenses or activities?

22              A.       Yes. We have literally -- I checked -- I  
23      have to file between a hundred and 200 monitoring reports  
24      on different items, and we file them either on a monthly or  
25      annual basis with either the CPUC, the FCC, the Securities  
26      and Exchange Commission or other regulatory agencies.

27              Q.       Now then, have you had an opportunity to go  
28      back and look at whether the profits from Centrex are

1 sufficient to cover the costs of Joint Marketing?

2 A. Yes, I have.

3 Q. And could you give us the total amount of the  
4 operating expense for Joint Marketing for 1991?

5 A. Yes. The operating expense for Joint  
6 Marketing in 1991 was \$5,487,635.

7 Q. I'll just round it off to thousands.  
8 And this is for 1981?

9 A. No, 1991.

10 Q. I'm sorry, 1991. And what were the -- can  
11 you tell me what the total net operating revenue was for  
12 Centrex for that year?

13 A. In 1991 the net operating revenue for Centrex  
14 was 98,216,208.

15 Q. Well, I don't know if anybody can read that,  
16 but I hope so. How about -- can you tell me the expense  
17 for 1992, the total operating expense for the Joint  
18 Marketing Program?

19 A. 6,312,787.

20 Q. And what was the Centrex revenue for that  
21 year?

22 A. Well, this is the net operating revenue, so  
23 it's revenue minus expense. It was 112,806,203.

24 Q. So the expense was about -- a little over six  
25 million, and the revenue from Centrex was about 112  
26 million?

27 A. No, that's the net operating revenue. That's  
28 the revenue minus expense, so that's the measure of profit

1 for Centrex.

2 Q. Okay. Now then, in -- how about 1993?

3 A. 1993, the Joint Marketing Part 64 operating  
4 expenses were 6,946,833.

5 Q. And what was the Centrex revenue after you  
6 take expenses out?

7 A. 136,157,273.

8 Q. Now, so that we're real clear on this, this  
9 figure is what's left from Centrex revenues after you take  
10 out the Centrex expenses; is that correct?

11 A. Yes. The Centrex operating expenses.

12 Q. And this is the -- these are the total  
13 expenses for the Joint Marketing Program?

14 A. Yes. For both the Referral and the Contracts  
15 Program.

16 Q. Now then, let me ask you, these figures are  
17 the -- essentially figures from the tracking sheets for  
18 contracts?

19 A. Yes. They're from the Part 64 FCC cost  
20 allocations on the Joint Marketing Programs for Contracts  
21 and for the Referral Program.

22 Q. Okay. And in what way would you normally use  
23 the costs on the FCC tracking sheets for making  
24 determinations as to pricing?

25 A. We wouldn't use them at all.

26 Q. And why wouldn't you use those allocations  
27 for pricing?

28 A. Well, the allocations don't really reflect

1 bill them separately.

2 MR. KIMBALL: I have no further questions, your  
3 Honor, and I would like to have this witness subject to  
4 recall in our case.

5 THE COURT: The witness may step down.

6 THE WITNESS: Thank you, your Honor.

7 THE COURT: You may call your next witness.

8 MR. JONES: Your Honor, Plaintiffs call Mr. Scott  
9 Morgan.

10 THE COURT: He may be sworn.

11

12 SCOTT MORGAN, +  
13 called as a witness by the plaintiffs, was sworn and  
14 testified as follows:

15 THE CLERK: Please be seated.

16

17 DIRECT EXAMINATION +

18 BY MR. JONES:

19 Q. Sir, could you please identify yourself for  
20 the record?

21 A. My name is Scott Morgan.

22 Q. And where are you currently residing,  
23 Mr. Morgan?

24 A. Reno, Nevada.

25 Q. And did there come a time that you were  
26 employed by Team Centrex?

27 A. Yes.

28 Q. And approximately when was it that you

1 other than Team Centrex?

2 A. Oh, yeah. Sure.

3 Q. And what, if anything, did you note in  
4 terms of chain of the level of competition in the Centrex  
5 CPE portion of this market after Pacific Bell implemented  
6 Joint Marketing?

7 A. Well, I always thought of it as a cottage  
8 industry that was developed specifically to serve the  
9 needs of Pacific Bell, and I would guess that there were  
10 around 10 companies or 15 companies in the State of  
11 California.

12 After that period of time when Joint  
13 Marketing occurred, many of those companies either went  
14 out of business or went out of that business.

15 In my case, I went out of that business.

16 MR. JONES: Nothing further, your Honor.

17 THE COURT: Anything further?

18 MS. DAVIS: I do, your Honor. It will take about  
19 two minutes, I think.

20 THE COURT: Well, given the fact that it's already  
21 11:30, we'll put that over to this afternoon.

22 And ladies and gentlemen, we resume at  
23 1:30.

24 Remember you're not to discuss the case  
25 among yourselves.

26 Court is in recess until 1:30.

27

28 (At 11:30 a.m. a recess was taken